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SUBJECT: SARG SENDING MIXED SIGNALS ON FUEL SUBSIDIES

Classified By: Charge d'Affaires Michael Corbin for reasons
1.4(b,d).

SUMMARY

1.(C) In the latest installment of a lurching, two-year debate in which President Asad has straddled the fence, the SARG has cautiously moved closer to lifting government subsidies on petroleum by-products, but when and how it will do so remains unclear. If implemented along the lines currently under discussion, the decision would likely raise the price of gasoline by 33 percent immediately, followed by an eventual 71 percent increase in diesel prices. According to DPM Dardari, the SARG has "no alternative" but to lift fuel subsidies in order to counter rampant smuggling, and will "redistribute" subsidies to Syria's "most deserving" citizens. Oil-industry sources tell Post that fuel shortages are inevitable for 2008, and the problem will only be exacerbated by delaying the decision. But, the timing of this decision seems particularly bad coming after a summer marked by widespread electricity shortages, rising inflation, and continued water rationing. After six weeks of unusually open and intense public criticism of the SARG's decision to lower subsidies, the regime appears ready to postpone its implementation for now. Local economists tell us that Syria has the foreign currency reserves necessary to maintain the subsidy status quo, but at a considerable cost to continued economic growth. End summary.

THE CONTEXT

12. (U) Since the Regional Congress of the Ba'ath Party first embraced a "social market economy" in June 2005, the SARG has periodically warned the Syrian public that economic transformation will necessitate cancellation of 40 years of government subsidies in favor of market-based commodity pricing. In his July 17 inaugural address, President Asad assured the public that government subsidies would not be cancelled, despite recent rumors to the contrary. The following week, however, both Deputy Prime Minister (DPM) for

Economic Affairs Abdullah al-Dardari and Prime Minister Muhammad Naji Otri went on record framing a subsidy policy change as a necessary "redistribution" of subsidies to Syria's poorest citizens. An increasingly concerned public finally reacted on August 22, after Dardari said the SARG "had no alternative but to increase fuel prices." The next several days witnessed long lines at gas stations, claims of diesel-distributors hoarding supplies, unprecedented media criticism, and anticipatory price-increases on many goods.

13. (C) In response to the public reaction, the SARG seems to be backing away from Dardari's comments of late August. On September 2, Dardari told a meeting of provincial governors and economic ministers that any modification to the subsidies would not be implemented "in the next days or weeks," until the technicalities of redistribution could be more thoroughly discussed by all stakeholders. The following day, President Asad heard complaints about the proposed redistribution scheme from the leadership of the Ba'ath Party-dominated National Progressive Front (NPF), and assured them that any subsidy change would have a positive impact on Syrians, lives. Separately, in a sign of public concern over inflation, two government-backed business NGOs have taken out newspaper advertisements this week calling on merchants to stop artificially inflating prices. Local staff also observed that imams publicly admonished merchants for the recent price-hikes during last Friday's sermons, presumably at the SARG's direction.

WHAT IS MOTIVATING THE SARG?

14. (C) Publicly, the SARG is rationalizing the subsidy redistribution as a campaign to rein in corruption, stop smuggling, and better serve the neediest elements of Syrian society. On 25 July, PM Otri explained that Syria had to bring fuel prices in line with that of its neighboring countries in order to counter the rampant smuggling of subsidized Syrian fuel. A well-connected oil-industry source calculated that smuggling to Lebanon, Turkey and Jordan had cost the SARG USD 1 billion this year alone. Otri also blamed what he termed the "1.5 million Iraqi refugees," and other non-Syrian residents, for "exhausting a large part of the subsidy allocations," and said that redistribution would remove the Iraqis from the equation. On August 27, Dardari complained that the wealthiest ten percent of the population was monopolizing some 56 percent of subsidies due to the pervasive corruption in Syria.

15. (C) Practically, the SARG is grappling with its inability to meet the burgeoning Syrian demand for petroleum by-products without jeopardizing its future plans for economic development. The absorption of large numbers of Iraqi refugees has undoubtedly contributed to increased demand, but to a degree that is difficult to determine. Significantly, Syria has also experienced a 25 percent increase in the number of registered cars on its roads over the past two years. A top industry expert estimated that the SARG will need to import 140,000 to 160,000 bpd of petroleum in 2008 to meet the increasing energy demand. However, insufficient refining capacity and port infrastructure will likely result in fuel shortages next year, he added, regardless of the volume of imports.

16. (C) As well as reducing smuggling, the SARG is counting on higher-priced fuel to curb domestic consumption. Middle-class Syrians, however, doubt that higher gasoline prices will decrease the Syrian demand, saying that Syrians would instead make budgetary sacrifices elsewhere. DPM Dardari has also expressed concern that, at the present rate, petroleum subsidies will increase public debt and erode foreign currency reserves to an extent that would threaten the stability of the Syrian pound.

THE PLAN

17. (U) Dardari,s plan, which dates from 2005, would phase out all petroleum subsidies over five years in an effort to strengthen the Syrian economy and return the budget deficit to no more than five percent of GDP. Analysts predict that gasoline will be the first fuel subsidy to disappear, which would raise the price from 30 SP per liter (USD 2.27 / gal) to 40 SP / liter (USD 3.03 / gal). Of greater significance will be the end of subsidized "mazout" (diesel and heating oil), which will raise the price by 71 percent from 7 SP / liter (USD 0.53 / gal) to 12 SP / liter (USD 0.91 / gal). As "mazout" is the primary fuel for agricultural production, heating, and cargo transportation, this increase will be immediately reflected in the price of goods and services.

18. (C) Details of the plan to redistribute subsidies have yet to be finalized, but two main ideas are under discussion. First, over a period of two years, Syrian society at large would be divided into ten categories, with the poorest seven categories slated to receive either an annual cash fuel allowance of 12,000 SP (USD 240) or a 10-12 per cent wage increase. Next, perquisites of certain public sector employees will be reduced. Office and branch directors will lose the free maintenance they have enjoyed on the aging fleet of government-provided cars, and instead receive an annual 2000 SP (USD 40) maintenance allowance. Assistant office directors and other middle-managers will no longer be entitled to government cars at all, a loss with potentially significant repercussions for the ten percent of the population employed by the public sector. As one source put it, for the average Syrian "the difference between having a car or not is the difference between getting married or not."

THE MEDIA,S ROLE IN MEDIATING COMPETING SYRIAN INTERESTS

19. (C) The role of the media in the subsidy debate is worth noting, given regime censorship. One government-sponsored newspaper, Tishreen, described the government,s plan and its anticipated inflationary effect as a "tsunami of prices," and reported on parents who have been unable to provide meat for their children in months. Some local businessmen interpret this negative coverage as a SARG attempt to provide an outlet for the public,s anger. On September 5, "official" sources speaking to the limited-circulation Syria Steps claimed that the leadership of the NPF and Ba,ath Party opposed the decision to lift subsidies, in an attempt to insulate the party from the public,s anger. Local consumers complain that merchants have already raised prices in anticipation of future diesel costs, and that delaying the implementation for further debate will result in a secondary price-hike as the eventual date approaches. In response, some newspaper editorials have even called on the SARG to "just do it" overnight in order to deny merchants the opportunity to raise prices again.

OIL EXPERT: SARG IS SERIOUS THIS TIME

110. (C) According to a very senior oil-industry contact who meets regularly with DPM Dardari, the SARG is "serious this time" about finally cutting the subsidies, and the cuts will happen before the details of the redistribution scheme are finalized. The contact posited that cuts could commence as early as October 1 for gasoline, with diesel and other oil by-products to follow by early 2008. Regarding the persistent electricity shortages that have affected Syria all summer, the contact said that Dardari was more worried about electricity supply during the upcoming winter months than the summer, as the Iraqi refugees in particular rely on subsidized products like liquid propane gas (LPG) and electricity for heat.

COMMENT

¶11. (C) It,s been a tough summer for the average Syrian consumer, who has endured the second consecutive year of year-round water rationing, unprecedented electricity shortages, and rising inflation) much of which has been blamed on the influx of Iraqi refugees. Traditionally, autumn in Syria is a period of major household expenditures as parents outfit their children for the new school year and families celebrate Ramadan. Consequently, the political timing seems ill-suited to enact a major policy change that would increase the public,s economic burden. The SARG may be facing an economic imperative to act with no other choice but to implement the unpopular decision sooner, rather than later. But the on-again, off-again nature of Syrian decision-making suggests that President Asad lacks the confidence to ratify a fiscally-sound, but politically unpopular decision that may reflect poorly on his regime.

CORBIN